EDFUND

FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

AND

INDEPENDENT AUDITOR'S REPORT

EDFUND

FINANCIAL STATEMENTS

For the Years Ended September 30, 2008 and 2007

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PERRY-SMITH LLP
ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors
EdFund
Rancho Cordova, California

We have audited the accompanying basic financial statements of EdFund, a component unit of the California Student Aid Commission, as of and for the years ended September 30, 2008 and 2007, as shown in the accompanying table of contents. These financial statements are the responsibility of EdFund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of EdFund's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of EdFund as of September 30, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PERRY-SMITH LLP
ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT
(Continued)

In accordance with *Government Auditing Standards*, we have also issued a report dated February 9, 2009 on our consideration of EdFund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit

EDFUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

This report consists of four parts: *The Independent Auditors' Report, Management's Discussion and Analysis (this section), Basic Financial Statements* (Balance Sheets, Statements of Revenues, Expenses, and Changes in Net Assets, and Statements of Cash Flows), and the *Notes to the Financial Statements*, which explain in further detail information contained in the financial statements.

This section of the EdFund financial statements presents management's discussion and analysis (MD&A) of its financial performance during the fiscal years ended September 30, 2008, 2007 and 2006. The information contained in this MD&A should be read in conjunction with the basic financial statements following this section.

EdFund, a nonprofit public benefit corporation, was created on January 2, 1997, as an auxiliary organization of the California Student Aid Commission (Commission) pursuant to Section 69522(a) of the California Education Code. The creation of EdFund was authorized by state legislation that empowered the Commission to establish a nonprofit auxiliary to carry out all activities associated with its participation in the Federal Family Education Loan (FFEL) Program. EdFund is a proprietary component unit of the Commission, and operates under terms and conditions set forth in an annual operating agreement between the two organizations. In order to fully understand the nature of and the expenses associated with administering the FFEL Program, the EdFund financial statements should be read in conjunction with the financial statements of the Commission's Federal Student Loan Reserve Fund (Federal Fund) and Student Loan Operating Fund (Operating Fund) as of and for the years ended June 30, 2008, 2007 and 2006.

In administering the loan program on behalf of the Commission, EdFund tracks cash activity related to lender claim payments, collection of defaulted loans, and federal default fee payments. In addition to this activity, EdFund's bank accounts are also used to deposit funds associated with administrative fees paid by the U.S. Department of Education (ED). These cash transactions are verified, recorded, and transferred to or reimbursed from the Commission's Student Loan Operating or Federal Funds. As a result of this arrangement, the EdFund Balance Sheets and Statements of Cash Flows reflect substantial fluidity from one accounting period to another.

Financial Highlights

In 2007-08, EdFund, on behalf of the Commission, administered the guarantee for $8.2 billion in FFEL program Stafford and PLUS loans to borrowers, serving 1,819 colleges and universities. This volume represents a 22 percent increase from the $6.7 billion annual loan volume guaranteed in 2006-07, serving 1,740 colleges and universities. Loan volume growth results from EdFund's efforts to preserve and build the portfolio by implementing federal default fee sharing strategies to reduce borrower costs, by improved technology offerings, and through providing exceptional customer service.

In both 2007-08 and 2006-07, total loan volume including consolidation loans equaled $9.3 billion. However, the portfolio mix changed as Stafford and Plus loan volume increased from $6.7 billion in 2006-07 to $8.2 billion in 2007-08, while consolidation loan volume declined from $2.6 billion in 2006-07 to $1.1 billion in 2007-08.

Claims totaling $1.1 billion were paid to lenders for defaulted loans in 2007-08, a 49 percent increase compared to the $740 million paid in 2006-07. This increase results from a rise in the rate of default in certain school types, an increase in the overall size of the outstanding portfolio, and a change in federal regulation terminating the exceptional performer (EP) program. The EP program provided higher insurance rates on loan defaults. However, when notified of the program ending, lenders accelerated their default claim filings to secure the higher insurance rate resulting in claim payments increasing substantially over a three month period that otherwise would have occurred much later, or potentially even averted entirely through default aversion efforts.

Collections recoveries from defaulted loans for 2007-08 totaled $456 million, a 52 percent increase from the $300 million collected during 2006-07. This increase reflects the exceptional success of EdFund's default management collection strategy to promote and improve rehabilitation loan recovery rates through enhanced automation tools and increased internal and external collection recovery performance.

In 2007-08, borrowers saved $45 million in federal default fees (FDF) paid on their behalf, a 105 percent increase compared to the $22 million funded in 2006-07.

Grant administrative costs for 2007-08 totaled $3 million, a 25 percent decrease from the $4 million incurred during 2006-07. These costs primarily represent funding for grant outreach and public awareness programs aimed at assisting and educating students on ways to fund their academic endeavors. The current year decrease reflects the reassignment of budget responsibility for grant administrative costs to the state General Fund and diminishing the support from EdFund in preparation for the eventual sale of the Commission's student loan program assets, commonly referred to as the "Sale of EdFund."

Total net assets decreased by nearly $8 million, to $22 million in 2007-08. This decrease is due primarily to funding a portion of the FDF subsidy directly from EdFund instead of the Commission's Operating Fund. To help mitigate education costs for students, the Commission approved an FDF policy on September 7, 2006 designed to share the FDF payment with lenders that meet certain criteria, on behalf of student borrowers. Effective July 1, 2007 the FDF strategy was implemented and lender participation is voluntary.

EdFund's Statements of Revenues, Expenses, and Changes in Net Assets reflect expenses incurred by EdFund on behalf of the Commission, and their subsequent reimbursement called program service fees. The nature of the operating agreement between the Commission and EdFund calls for a full reimbursement of all operating costs incurred by EdFund. As a result, program service fees and operating expenses will represent the same amounts after a standard accounting period close. Also specified in the operating agreement is the process where EdFund initially invests in capital asset purchases and is reimbursed by the Commission as the assets are used in the administration of the FFEL Program. The FDF subsidy funded from EdFund is classified as a non-operating expense and was not reimbursed by the Commission.

Financial Analysis

Assets	2008	2007	2006
Cash and cash equivalents	$ 106,210,483	$ 70,463,165	$ 35,480,343
Accounts receivable	10,036,857	5,523	321,807
Due from and other assets	11,603,415	14,330,379	42,708,066
Capital assets, net of accumulated depreciation	5,105,528	3,710,715	3,080,543
Total assets	$ 132,956,283	$ 88,509,782	$ 81,590,759
Liabilities and Net Assets			
Due to lending institutions	$ 43,370,725	—	—
All other current liabilities	62,468,425	$ 53,760,459	$ 49,007,760
Noncurrent liabilities	5,153,039	5,083,605	4,198,175
Total liabilities	110,992,189	58,844,064	53,205,935
Net assets:			
Invested in capital assets	5,105,528	3,710,715	3,080,543
Unrestricted	16,858,566	25,955,003	25,304,281
Total net assets	21,964,094	29,665,718	28,384,824
Total liabilities and net assets	$ 132,956,283	$ 88,509,782	$ 81,590,759

- Total assets exceeded liabilities by a total of $22 million at the end of the fiscal year 2007-08, compared to $30 million in 2006-07 and $28 million in 2005-06. The decreases in 2007-08 is attributable to funding a portion of the FDF subsidy costs directly from EdFund. This particular FDF share program ended September 30, 2008. In 2007-08, approximately $5 million of the $22 million in total net assets are invested in capital assets. In 2006-07, approximately $4 million of the $30 million in total net assets are invested in capital assets.
- Cash and cash equivalents increased $36 million, or 51 percent in 2007-08, compared to a similar increase of $35 million, or 99 percent in 2006-07. The current year increase is attributable to the timing of payments due to lending institutions for claims payments and the FDF share program payments funded by EdFund. At September 30, 2007 the increase was from a substantially lower receivable of $13 million due from the Commission's Operating Fund.
- Accounts receivable increased $10 million in 2007-08 compared to both 2006-07 and 2005-06 due primarily to a current year receivable from a lender for the purchase of rehabilitated loans.

- Due from and other assets decreased $3 million in 2007-08 compared to a $28 million decrease in 2006-07. The current year decrease primarily represents the receivable due from the Commission's Operating Fund at year-end for operating expense reimbursements. Similarly, the 2006-07 decrease primarily results from having a significantly lower receivable due from the Commission's Operating Fund at year-end for operating expense reimbursement as the cash position improved providing funds to pay outstanding obligations.
- Capital assets, net of accumulated depreciation, increased 38 percent, to $5 million in 2007-08, from the $4 million total reported in 2006-07. This increase in capital assets is attributable to the acquisition of assets purchased in conjunction with the relocation of EdFund's headquarters and technology data center. The 2006-07 increase is due to a limited number of technology related asset purchases made during the year.
- Due to lending institutions of $43,370,725 at September 30, 2008 represents $40,670,500 payable to lenders for claim insurance payments on behalf of the Commission and $2,700,225 in FDF subsidy costs due to lenders.

	2008	2007	2006
Operating revenues:			
Program service fees	$ 96,380,262	$ 90,175,944	$ 88,541,718
Total operating revenues	96,380,262	90,175,944	88,541,718
Operating expenses:			
Salaries and benefits	53,283,572	56,377,316	55,806,803
Collection agency fees	19,480,688	11,299,329	8,386,382
Consulting and professional fees	5,145,495	5,639,884	5,234,429
Facilities operations and rental expenses	5,853,174	3,995,033	3,960,626
Computer expense	2,710,821	2,480,753	3,494,580
Other operating expenses	9,906,512	10,383,629	11,658,898
Total operating expenses	96,380,262	90,175,944	88,541,718
Net operating revenues	—	—	—
Nonoperating revenues (expenses):			
Federal default fee subsidy	(8,561,136)	—	—
Grant administrative service fees	2,865,473	3,989,185	5,086,422
Interest income	859,512	1,280,894	902,630
Grant administrative costs	(2,865,473)	(3,989,185)	(5,086,422)
Total nonoperating revenues	(7,701,624)	1,280,894	902,630
Change in net assets	(7,701,624)	1,280,894	902,630
Net assets, beginning of year	29,665,718	28,384,824	27,482,194
Net assets, end of year	$ 21,964,094	$ 29,665,718	$ 28,384,824

- EdFund's total operating revenues increased $6 million, or 7 percent from 2006-07. In 2006-07, total operating revenues increased $2 million, or 2 percent compared to 2005-06. The change in program service fees between fiscal years is consistent with overall increases in operating expenses as these fees represent reimbursements to EdFund for managing FFEL program operational activities.

- Federal default fee subsidy costs were $9 million in 2007-08. This portion of the FDF subsidy was funded directly from EdFund, and not reimbursed by the Commission's Operating Fund. This particular FDF share program ended September 30, 2008.

- Grant administrative service fees decreased $1 million, or 28 percent, in 2007-08 compared to 2006-07. In 2006-07, grant administrative fees decreased $1 million, or 22 percent compared to 2005-06. These fees represent reimbursements for grant administrative and outreach costs incurred by EdFund in support of grant programs and public outreach campaigns as directed by the Commission.

- Interest income returns noted each year result from fluctuations in cash balances and the changes in interest rates experienced throughout the year.

- Total operating expenses for 2007-08 increased $6 million, or 7 percent, compared to 2006-07. However, certain expense lines experienced significant variances from prior year activity as follows:

  - Salaries and benefits decreased $3 million, or 5 percent, compared to the prior year. This decrease reflects management's continued emphasis on realizing operating efficiencies, offset by modest salary increases and growth in medical benefit costs.

  - Collection agency fees increased $8 million, or 72 percent, compared to 2006-07 and are directly related to the $156 million, or 52 percent, increase in gross collection recoveries compared to prior year due predominantly to the successful rehabilitation loan recovery strategy.

  - Consulting and professional fees decreased somewhat between years as management continues its cost saving efforts.

  - Facilities operations and rental expense increased $2 million in 2007-08 compared to the prior year due predominantly to paying duplicate rental costs during the fourth quarter associated with the relocations of the EdFund headquarters and technology data center.

  - Computer expenses and other operating expenses are relatively consistent compared to the prior year.

- In 2006-07, total operating expenses increased $2 million, or 2 percent, compared to 2005-06. However, certain expense lines experienced significant variances from prior year activity as follows:

  - Salaries and benefits remained relatively consistent compared to the prior year. Although overall salaries declined, this savings was offset by the continued growth in medical benefit costs.

  - Collection agency fees increased $3 million, or 38 percent, compared to 2005-06 and are directly related to the $7 million increase in gross collection recoveries compared to prior year.

- Consulting and professional fees increased slightly compared to 2005-06 primarily due to an increase in default prevention counseling efforts to assist delinquent borrowers from defaulting on their student loans.
- Computer expenses and other operating expenses decreased $1 million compared to the prior year reflecting EdFund management's efforts to improve operational efficiencies and control costs.

Significant Known Facts, Decisions, or Conditions

Chapter 132 of the Statutes of 2007 (Senate Bill 89) authorized the sale or other transaction of the Commission's student loan guarantee portfolio and certain related assets and liabilities of the student loan program, commonly referred to as the "Sale of EdFund." Senate Bill 89 also authorized the State Director of Finance to consummate other transactions to maximize the value of the state's student loan guarantee program. The 2008-09 State budget, signed into law on September 23, 2008, notes the sale has been postponed due to a variety of factors affecting the student loan guaranty industry. However, the state administration is continuing its efforts, pursuant to chapter 757 of the statutes of 2008 (Assembly Bill 519) that extends the sale authorization through January 10, 2011.

Information about the 2008-09 budget for the State of California is available through the Department of Finance budget website (www.ebudget.ca.gov).

EDFUND

BALANCE SHEETS

September 30, 2008 and 2007

	2008	2007
ASSETS		
Current assets:		
Cash and cash equivalents (Note 3)	$ 106,210,483	$ 70,463,165
Accounts receivable (Note 5)	10,036,857	5,523
Due from Operating Fund (Note 4)	10,435,816	13,432,577
Due from General Fund (Note 4)	154,059	—
Prepaid and other assets	1,013,540	897,802
Total current assets	127,850,755	84,799,067
Capital assets, net of accumulated depreciation (Note 6)	5,105,528	3,710,715
Total assets	$ 132,956,283	$ 88,509,782
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 727,019	$ 1,118,069
Due to Federal Fund (Note 4)	27,725,146	20,429,194
Due to lending institutions (Note 7)	43,370,725	—
Accrued payroll	5,530,677	4,966,858
Accrued expenses and other liabilities	8,485,583	7,246,338
Advance payable to the Commission (Note 2)	20,000,000	20,000,000
Total current liabilities	105,839,150	53,760,459
Noncurrent liabilities (Notes 9 and 10)	5,153,039	5,083,605
Total liabilities	110,992,189	58,844,064
Net assets:		
Invested in capital assets (Note 6)	5,105,528	3,710,715
Unrestricted	16,858,566	25,955,003
Total net assets	21,964,094	29,665,718
Total liabilities and net assets	$ 132,956,283	$ 88,509,782

The accompanying notes are an integral part of these financial statements.

EDFUND

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended September 30, 2008 and 2007

	2008	2007
Operating revenues:		
Program service fees	$ 96,380,262	$ 90,175,944
Total operating revenues	96,380,262	90,175,944
Operating expenses:		
Salaries and benefits (Notes 9 and 10)	53,283,572	56,377,316
Collection agency fees	19,480,688	11,299,329
Consulting and professional fees	5,145,495	5,639,884
Facilities operations and rental expense (Note 8)	5,853,174	3,995,033
Computer expense	2,710,821	2,480,753
Travel expenses	1,888,576	2,455,151
Depreciation expense (Note 6)	2,128,052	1,713,098
Printing expenses	768,859	1,109,201
Other operating expenses	5,121,025	5,106,179
Total operating expenses	96,380,262	90,175,944
Operating income (loss)	—	—
Non-operating (expenses) revenues:		
Federal default fee subsidy (Note 7)	(8,561,136)	—
Grant administrative service fees	2,865,473	3,989,185
Interest income, net (Note 3)	859,512	1,280,894
Grant administrative costs	(2,865,473)	(3,989,185)
Total non-operating (expenses) revenues	(7,701,624)	1,280,894
Change in net assets	(7,701,624)	1,280,894
Net assets, beginning of year	29,665,718	28,384,824
Net assets, end of year	$ 21,964,094	$ 29,665,718

The accompanying notes are an integral part of these financial statements.

EDFUND

STATEMENTS OF CASH FLOWS

For the Years Ended September 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from customers	$ 94,307,991	$ 117,706,037
Cash paid to suppliers and vendors	(62,746,457)	(45,520,476)
Cash paid to employees for services	(40,171,377)	(42,413,821)
Net cash (used in) provided by operating activities	(8,609,843)	29,771,740
Cash flows from noncapital financing activities:		
Purchase of defaulted loans	(822,907,371)	(727,424,573)
Reimbursements from the Commission of defaulted loans	863,577,871	727,424,573
Receipts from ED	854,014,106	568,528,331
Reimbursements to the Commission of amounts received from ED	(841,585,030)	(567,049,034)
Cash receipts from repurchased loans	21,992,841	17,451,826
Cash remitted to the Commission for repurchased loans	(21,992,841)	(17,451,826)
Cash receipts from collections	370,398,969	253,776,452
Cash remitted to the Commission for collections	(366,653,870)	(253,272,598)
Cash receipts from federal default fees	26,477,483	29,795,238
Cash remitted to the Commission for federal default fees	(30,440,733)	(25,504,931)
Federal default fee subsidy	(5,860,911)	—
Net cash provided by noncapital financing activities	47,020,514	6,273,458
Cash flows used in capital and related financing activities:		
Purchases of capital assets	(3,522,865)	(2,343,270)
Cash flows from investing activities:		
Interest received	1,928,809	2,265,848
Remittances to the Commission of interest received	(1,069,297)	(984,954)
Net cash provided by investing activities	859,512	1,280,894
Net increase in cash and cash equivalents	35,747,318	34,982,822
Cash and cash equivalents, beginning of year	70,463,165	35,480,343
Cash and cash equivalents, end of year	$ 106,210,483	$ 70,463,165
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Operating income	$ —	$ —
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
Depreciation expense	2,128,052	1,713,098
Change in assets and liabilities:		
Accounts receivable	(10,031,334)	316,284
Due from the Commission	(1,918,212)	27,530,094
Due from General Fund	(154,059)	—
Prepaid and other assets	(115,738)	234,357
Accounts payable	(391,050)	(662,898)
Accrued payroll	563,819	(332,296)
Accrued expenses and other liabilities	1,239,245	87,671
Noncurrent liabilities	69,434	885,430
Net cash (used in) provided by operating activities	$ (8,609,843)	$ 29,771,740

The accompanying notes are an integral part of these financial statements.

NOTES TO BASIC FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS

EdFund, a nonprofit public benefit corporation, was created on January 2, 1997 as an auxiliary organization of the California Student Aid Commission (the "Commission") pursuant to Section 69522(a) of the California Education Code. Additionally, EdFund is a component unit of the Commission.

EdFund was created to administer, operate, and provide services essential to the Commission's participation as a designated guaranty agency in the Federal Family Education Loan (FFEL) Program. Most of the expenses incurred for administering the FFEL Program are recorded in EdFund's financial records while other expenses incurred for administering the FFEL Program are recorded in financial statements of the Commission. In order to fully understand the nature of and the expenses associated with administering the FFEL Program, the EdFund financial statements should be read in conjunction with the financial statements of the Commission's Federal Student Loan Reserve Fund (Federal Fund) and Student Loan Operating Fund (Operating Fund) as of and for the year ended June 30, 2008.

EdFund operates under the terms and conditions set forth in an annual operating agreement between the Commission and EdFund. The operating agreement is renewed or extended annually on July 1. Under the agreement, EdFund is reimbursed for expenses incurred on behalf of the Commission in administering the FFEL Program. In the event that the annual operating agreement should terminate and in the absence of a subsequent agreement, EdFund assets become the property of the Commission.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The accounts of EdFund are maintained in accordance with the principles of fund accounting. Fund accounting is a system under which resources are classified for accounting and reporting purposes into funds established according to their purpose.

EdFund is a proprietary component unit of the Commission. Proprietary component units use the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow. The financial statements of EdFund have been prepared in accordance with accounting principles generally accepted in the United States of America, including all applicable statements of the Governmental Accounting Standards Board (GASB), as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions, issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. EdFund has not applied accounting standards issued after November 30, 1989 by the FASB.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Tax-Exempt Status

EdFund qualifies as a tax-exempt organization under Section 501(c)(3) of the United States Internal Revenue Code and corresponding provisions of California law and, accordingly, is not subject to federal or state income taxes.

(c) Capital Assets

Capital assets are those assets purchased or acquired with an original cost of $5,000 or more. Additions, improvements or other capital outlays that significantly extend the useful life of an asset are capitalized. These assets are reported at historical cost and are depreciated using the straight-line method over their estimated useful lives of three to ten years (term of lease as to leasehold improvements). Costs incurred for repairs and maintenance are expensed as incurred. EdFund evaluates capital assets for financial impairment as events or changes in circumstances indicate that the carrying amounts of such assets may not be fully recoverable.

(d) Revenue Recognition

Program service fee revenue represents an amount equal to the expenses incurred by EdFund in administering the FFEL Program on behalf of the Commission. Program service fee revenue is recognized when the related expense is incurred.

Operating revenues and expenses result from exchange transactions associated with the principal activities of EdFund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues and expenses, such as the federal default fee subsidy, interest income, and grant administrative service fees and costs, result from nonexchange transactions and/or revenues and expenses not earned or incurred in administering the FFEL Program.

(e) Salaries

EdFund has two types of employees: employees directly hired by EdFund and civil service employees of the Commission who have been assigned to work for EdFund (assigned employees). Salary expense includes the salaries, wages, and related benefits of both EdFund employees and the assigned employees. The salaries, wages and related benefits of the assigned employees are paid by the Commission and EdFund reimburses the Commission for those amounts.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Related Party Transactions

On January 2, 1997, the Commission advanced $20,000,000 to EdFund for operating capital. The terms of the advance have not been clearly defined and, therefore, are determined to be due on demand. As of September 30, 2008, no payments were required. Interest income earned on the unused portion of the advance is reimbursed to the Commission.

As described more fully in Note 1, the majority of EdFund's revenues are earned under the operating agreement with the Commission.

As described more fully in Note 4, expenses incurred by EdFund as a function of performing FFEL services for the Commission are reimbursable from the Commission.

(g) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

(h) Reclassification

Certain reclassifications have been made to prior year's balances to conform to classifications used in 2008.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Implementation of New Financial Accounting Pronouncement

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

In June 2004, the Governmental Accounting Standards Board ("GASB") issued Statement of Governmental Accounting Standard No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, ("GASB 45"). GASB 45 addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. GASB 45 generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of GASB 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. GASB 45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. GASB 45 is effective in three phases based on a government's total annual revenues. EdFund implemented GASB 45 in fiscal year June 30, 2008 (Note 9).

3. CASH AND CASH EQUIVALENTS

At September 30, 2008, EdFund maintained cash equivalents of $81,212,677 and money market deposit accounts in the amount of $24,997,806. At September 30, 2007, EdFund maintained cash equivalents of $40,235,016 and money market deposit accounts in the amount of $30,228,149. Interest earned on cash equivalents is allocated between EdFund and the Commission based on daily balances of accounts attributable to each entity. Interest earned on unused monies of the operating advance is due to the Commission and EdFund retains the remaining interest earned.

At September 30, 2008 and 2007, the carrying value of the cash and cash equivalents approximated its market value because of its short-term maturity. Interest earned for the year ended September 30, 2008 totaled $1,928,809 of which $1,069,297 was allocated to the Commission. Interest earned for the year ended September 30, 2007 totaled $2,265,848 of which $984,954 was allocated to the Commission.

3. CASH AND CASH EQUIVALENTS (Continued)

Custodial credit risk is the risk that in the event of a bank failure, EdFund's deposits may not be returned. EdFund does not have a deposit policy for custodial credit risk. EdFund maintains cash and cash equivalent accounts which are insured by either the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC). The California Government Code requires California banks and savings and loan associations to secure EdFund's deposits by pledging government securities as collateral. The market value of pledged securities must equal 110 percent of an agency's deposits. California law also allows financial institutions to secure an agency's deposits by pledging first trust deed mortgage notes having a value of 150 percent of an agency's total deposits, and collateral is considered to be held in the name of EdFund. All cash held by financial institutions is entirely insured or collateralized. As of September 30, 2008 and 2007, EdFund had insured cash and cash equivalent balances of $700,000 and uninsured but collateralized balances of $109,195,002 and $72,270,848, respectively.

As a component of the Commission, EdFund conforms to the investment policy of the State Treasurer and the Federal regulatory FFEL Program fiscal requirements which govern reserve fund investments. Additional information on the State Treasurer's investment policy, including investment credit type, interest rate risk and concentration of credit risk, is available at the State Controller's website (www.sco.ca.gov).

4. DUE (TO) FROM THE COMMISSION

Expenses incurred as a function of performing FFEL services for the Commission or amounts paid on behalf of the Commission by EdFund, are reimbursable from the Commission. Conversely, all monies received by EdFund on behalf of the Commission are due to the Commission.

The net amount due (to) from the Commission at September 30, is comprised of the following:

	2008	2007
Amounts due from the Commission:		
Due from Operating Fund	$ 10,435,816	$ 13,432,577
Amounts due to the Commission:		
Due to Federal Fund	(27,725,146)	(20,429,194)
Due to the Commission	$ (17,289,330)	$ (6,996,617)

5. ACCOUNTS RECEIVABLE

EdFund was created to administer, operate, and provide services essential to the Commission's participation as a designated guaranty agency in the FFEL program. Services include collecting funds and remitting them to the Commission. At September 30, 2008, $10,034,523 of the total $10,036,857 accounts receivable was due from a lender for rehabilitation loan purchases for which funds had already been remitted by EdFund to the Commission. The funds were received from the rehabilitation lender in early October 2008. At September 30, 2007, there were no receivables due from lenders for rehabilitated loan purchases.

6. CAPITAL ASSETS

Capital asset activity for the year ended September 30, 2008 is as follows:

	Beginning Balance	Transfers and Additions	Transfers and Disposals	Ending Balance
Vehicles	$ 58,186	$ —	$ —	$ 58,186
Computer equipment	4,378,598	548,775	(801,631)	4,125,742
Computer software	5,175,768	1,283,554	—	6,459,322
Equipment, furniture and fixtures	1,533,221	2,318,438	(12,759)	3,838,900
Leasehold improvements	335,347	411,267	—	746,614
Construction in progress	1,176,234	137,816	(1,176,234)	137,816
	12,657,354	4,699,850	(1,990,624)	15,366,580
Less accumulated depreciation:				
Vehicles	(54,607)	(3,579)	—	(58,186)
Computer equipment	(3,605,468)	(605,215)	801,631	(3,409,052)
Computer software	(4,247,910)	(1,137,235)	—	(5,385,145)
Equipment, furniture and fixtures	(703,577)	(374,900)	12,008	(1,066,469)
Leasehold improvements	(335,077)	(7,123)	—	(342,200)
	(8,946,639)	(2,128,052)	813,639	(10,261,052)
Capital assets, net	$ 3,710,715	$ 2,571,798	$ (1,176,985)	$ 5,105,528

6. CAPITAL ASSETS (Continued)

Capital asset activity for the year ended September 30, 2007 is as follows:

	Beginning Balance	Transfers and Additions	Transfers and Disposals	Ending Balance
Vehicles	$ 58,186	$ —	$ —	$ 58,186
Computer equipment	4,879,166	251,303	(751,871)	4,378,598
Computer software	4,984,459	191,309	—	5,175,768
Equipment, furniture and fixtures	804,675	777,749	(49,203)	1,533,221
Leasehold improvements	335,347	—	—	335,347
Construction in progress	43,673	1,154,617	(22,056)	1,176,234
	11,105,506	2,374,978	(823,130)	12,657,354
Less accumulated depreciation:				
Vehicles	(40,814)	(13,793)	—	(54,607)
Computer equipment	(3,755,384)	(597,505)	747,421	(3,605,468)
Computer software	(3,396,651)	(851,259)	—	(4,247,910)
Equipment, furniture and fixtures	(589,287)	(158,291)	44,001	(703,577)
Leasehold improvements	(242,827)	(92,250)	—	(335,077)
	(8,024,963)	(1,713,098)	791,422	(8,946,639)
Capital assets, net	$ 3,080,543	$ 661,880	$ (31,708)	$ 3,710,715

7. DUE TO LENDING INSTITUTIONS AND FEDERAL DEFAULT FEE SUBSIDY

The Higher Education Reconciliation Act of 2005 required the assessment of a Federal Default Fee (FDF) on all loans guaranteed on or after July 1, 2006, equal to 1 percent of the principal amount of the loan, be deposited into the Federal Fund within 45 days of disbursement. To help mitigate education costs for students, on September 7, 2006 the Commission approved an FDF policy designed to share the FDF payment with lenders that meet certain criteria, on behalf of student borrowers. Effective July 1, 2007, the FDF strategy was implemented and ongoing lender participation is voluntary. The FDF policy allows for an annual review of the FDF share program and associated program amendments.

While the Commission's Operating Fund typically funds FDF subsidy costs, for fiscal year 2008 EdFund directly funded a portion of FDF subsidy expenses paid to lenders. As such, included in nonoperating revenues (expenses) is FDF subsidy costs of $8,561,136 for the year ended September 30, 2008.

At September 30, 2008, EdFund's Due to Lending Institutions of $43,370,725 is comprised of $40,670,500 payable to lenders for claim insurance payments due on behalf of the Commission and $2,700,225 in FDF subsidy costs.

8. COMMITMENTS

Operating Leases

EdFund maintains various operating leases for its main and regional offices. Rental expense for the years ended September 30, 2008 and 2007 was $5,004,609 and $3,237,894, respectively. Future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of September 30, 2008, are as follows:

Year Ending September 30,	Gross Obligation Per Lease Agreements
2009	$ 5,211,068
2010	5,295,715
2011	5,132,785
2012	4,870,190
2013	4,977,066
Thereafter	24,188,139
	$ 49,674,963

9. RETIREMENT BENEFITS

EdFund Employees

Effective July 1, 1997, EdFund established a defined contribution retirement savings plan comprised of the EdFund Employees' Retirement Plan 403(b) and the EdFund Employer Contribution Plan 401(a) for those employees hired by EdFund. Effective January 1, 2003, EdFund established the new EdFund 401(k) Plan. The 403(b) Plan was "frozen" and beginning January 1, 2003 employee voluntary contributions were made into the new 401(k) Plan. In addition, the 401(a) Plan converted to the new EdFund 401(k) Plan. EdFund makes a non-elective contribution on behalf of each EdFund employee. In addition, all regular full-time and part-time employees over the age of 18 and working more than 20 hours per week may contribute on a pre-tax basis from 1 percent to 90 percent of their annual compensation up to the Internal Revenue Service limits. EdFund contributes a percentage match of 100 percent of employee contributions up to 4 percent of deferred salary.

The defined contribution retirement savings plan is administered by Fidelity Investments. Amendments to the defined contribution retirement savings plan are subject to approval and ratification by EdFund's Board of Directors.

Total covered payroll for the EdFund employees was $38,588,260 and $40,776,137 for the years ended September 30, 2008 and 2007, respectively. Total employer contributions and employee contributions were $3,006,613 and $2,921,639, respectively, for the year ended September 30, 2008, and $3,326,027 and $3,073,401, respectively, for the year ended September 30, 2007.

9. RETIREMENT BENEFITS (Continued)

Post-Retirement Healthcare Benefits

In addition to the defined contribution retirement savings plan benefits, EdFund provides post-retirement benefits through the EdFund Post-retirement Medical and Life Plan (the "Plan"). The Plan provides for medical, dental, vision and life insurance benefits to employees based on age upon retirement and length of service. The post-retirement healthcare benefits are funded on a pay-as-you-go basis and the related expenses and liabilities are calculated using the actuarial-based accrual method. EdFund uses a September 30 measurement date and assumed that the annual discount rate is 5.0 percent and 6.0 percent at the end of the measurement periods September 30, 2008 and 2007.

EdFund's annual other post-employment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of EdFund's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the OPEB obligation:

Annual required contribution	$ 423,122
Interest on net OPEB obligation	214,711
Adjustment to annual required contribution	(143,141)
Annual OPEB cost (expense)	494,692
Contributions made	(82,442)
Increase in net OPEB obligation	412,250
Adjustment to beginning balance	(234,778)
Net OPEB obligation - beginning of year	4,529,000
Net OPEB obligation - end of year	$ 4,706,472

EdFund's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended September 30, 2008 and 2007 were as follows:

Fiscal Years Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
September 30, 2007	$ 603,062	12.9%	$ 4,529,000
September 30, 2008	$ 494,692	16.7%	$ 4,706,472

9. RETIREMENT BENEFITS (Continued)

Post-Retirement Healthcare Benefits (Continued)

As of February 7, 2008, the most recent actuarial valuation date, the plan was not funded. The actuarial accrued liability for benefits and unfunded actuarial accrual liability (UAAL) was $5.9 million. The covered payroll (annual payroll of active employees covered by the Plan) was $4.0 million, and the ratio of the UAAL to the covered payroll was 147.5 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the February 7, 2008, actuarial valuation, the projected unit credit cost method was used. The actuarial assumptions included a 5.0 percent investment rate (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan on the valuation date, and an annual healthcare cost trend rate of 10 percent initially, reduced by decrements to an ultimate rate of 5.0 percent after 10 years, dental and vision trend rates of 3.0 percent, retirement rates of 100 percent at 62 years of age, and a 0.15 percent withdrawal rate from ages 25 through 35 and 0.10 percent for ages 40 through 55. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at September 30, 2008, was 29 years.

9. RETIREMENT BENEFITS (Continued)

Assigned Employees

All assigned employees are eligible to participate in the California Public Employees' Retirement System (PERS). PERS, a multiple-employer defined benefit retirement plan, is administered by a Board of Administration composed of individuals (1) elected by PERS membership; (2) appointed by elected State of California officials; and (3) elected State of California officials. PERS provides retirement, disability, and death benefits. Such benefits are based on the employee's years of service, age, and final compensation. PERS issues a publicly available financial report that includes financial statements and required supplementary information, which may be obtained by writing to California Public Employees' Retirement System, 400 Q Street, Sacramento, California 95811-6210.

Assigned employees may participate in PERS at one of three levels; first-tier participants contribute a portion of their salaries to a retirement fund, second-tier employees do not make contributions and Alternate Retirement Program (ARP) participants contribute to a special retirement account for the first two years of state service. The ARP was established for State of California employees hired on or after August 11, 2004. All new state civil service employees are automatically enrolled in ARP for the first two years of employment with the state. After two years, employees will have the option of choosing between the first-tier and second-tier. In addition to the employee's contributions to PERS, the state also contributes into PERS towards civil service retirement benefits. The state's contribution varies annually based on the Budget Act. First-tier employees vest after five years of service and may receive retirement benefits at age 50. Second-tier employees vest after ten years of service and may receive retirement benefits at age 55. As of September 30, 2008 and 2007, there were 17 and 39 employees classified as first tier, respectively. As of September 30, 2008, there were no employees classified as second tier. As of September 30, 2007 there were 2 employees classified as second tier and no employees participating in the ARP, supporting direct FFEL Program activities. State records relating to pension benefit obligations and new assets available for benefits are not separately available for EdFund.

Total PERS expense and funded contributions for the assigned employees was \$278,672 and \$460,827 for the years ended September 30, 2008 and 2007, respectively. All contributions were paid as of September 30, 2008.

10. DEFERRED COMPENSATION

EdFund offers certain employees a deferred compensation plan "rabbi trust" created in accordance with Internal Revenue Code Section 457. The Plan, available to select employees permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the Plan are placed in trust for participants and their beneficiaries. Included in noncurrent liabilities is the Deferred Compensation Obligation of \$446,567 and \$554,605 for the years ended September 30, 2008 and 2007, respectively.

11. SUBSEQUENT EVENTS

Chapter 132 of the Statutes of 2007 (Senate Bill 89) authorized the sale or other transaction of the Commission's student loan guarantee portfolio and certain related assets and liabilities of the student loan program, commonly referred to as the "Sale of EdFund." Senate Bill 89 also authorized the State Director of Finance to consummate other transactions to maximize the value of the state's student loan guarantee program. The 2008-09 State budget, signed into law on September 23, 2008, notes the sale has been postponed due to a variety of factors affecting the student loan guaranty industry. However, the state administration is continuing its efforts, pursuant to chapter 757 of the statutes of 2008 (Assembly Bill 519) that extends the sale authorization through January 10, 2011.

Information about the 2008-09 budget for the State of California is available through the Department of Finance budget website (www.ebudget.ca.gov).

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
EdFund
Rancho Cordova, California

We have audited the financial statements of EdFund as of and for the year ended September 30, 2008, and have issued our report thereon dated February 9, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered EdFund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of EdFund's internal control over financial reporting. Accordingly, we do not express an opinion of the effectiveness of EdFund's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects EdFund's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of EdFund's financial statements that is more than inconsequential will not be prevented or detected by EdFund's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by EdFund's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

(Continued)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the EdFund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the Board of Directors, management, and others, and is not intended to be and should not be used by anyone other than those specified parties.

Perry-Smith LLP

Sacramento, California
February 9, 2009